Supreme Court, U.S.
FILED
JUN 15 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. 89-1795

In The

Supreme Court of the United States

October Term, 1989

BLUNT ELLIS & LOEWI INCORPORATED,
JOHN FROMM and PETER PFEFFER,

Petitioners,

vs.

RONALD P. HLAVINKA and
JIMMIE G. DAVISON,

Respondents.

BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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June 14, 1990

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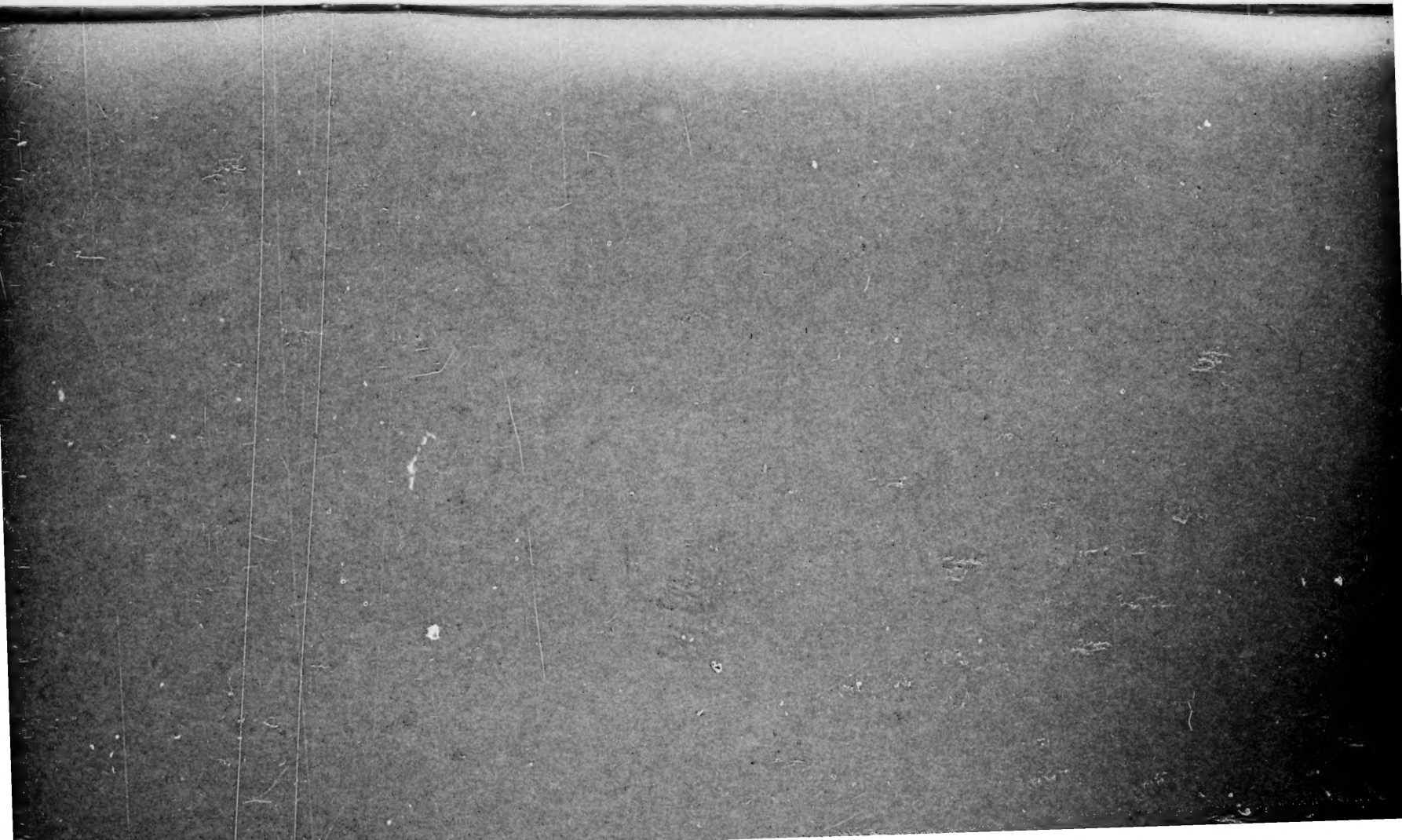

QUESTION PRESENTED

Whether a decision in a court of limited jurisdiction by an Administrative Law Judge in a reparations action pursuant to the Commodity Exchange Act (7 U.S.C. Section 18 (1982)), jurisdictionally bars issues that could not be raised before the Administrative Law Judge, from being raised in a subsequent action before a Court that has the jurisdiction to address and decide them?

PARTIES IN THE PROCEEDING BELOW

Petitioners, Blunt, Ellis & Loewi, Incorporated, Peter Pfeffer and John Fromm, were petitioners in the proceeding below in the Seventh Circuit Court of Appeals. Ronald P. Hlavinka and Jimmie G. Davison were respondents in that proceeding. All of the above, except for Mr. Davison, were parties in the Commission reparations proceedings.

Blunt, Ellis & Loewi, Incorporated is a Delaware corporation and is wholly owned by Kemper Financial Services, Inc. ("KFSI") also a corporation. KFSI is wholly-owned by Kemper Corp., a Delaware corporation listed for trading on the New York Stock Exchange.

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No. 89-1795

In The

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October Term, 1989

BLUNT ELLIS & LOEWI INCORPORATED,
JOHN FROMM and PETER PFEFFER,

Petitioners,

vs.

RONALD P. HLAVINKA and
JIMMIE G. DAVISON,

Respondents.

BRIEF IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Ronald P. Hlavinka and Jimmie G. Davison ("Hlavinka") respectfully petition for the denial of the Writ of Certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINION BELOW

The opinion of the Court of Appeals (Pet. App. 2-4) is reported at 897 F.2d 240.

JURISDICTION

The judgment of the Court of Appeals (Pet. App. 1) was entered on February 16, 1990. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. Section 1254(1).

STATUTES AND REGULATIONS INVOLVED

The relevant statutes and regulations, which are reproduced in relevant part in Petitioners Appendix (Pet. App. 39-46), are Sec. 14(a), (b) and (e) and Sec. 22(a) and (c) of the Commodity Exchange Act (the "CEA"); codified at 7 U.S.C. Section 18(a), (b) and (e) and 7 U.S.C. Section 25(a) and (c). Section 2283 of the Judicial Code, 28 U.S.C. Section 2283 is also involved. Commodity Futures Trading Commission (the "Commission") regulations are 17 CFR Sections 12.13(a), 12.15(a) and (b), and 12.24(a), (c) and (e).

STATEMENT OF THE CASE

On December 2nd, 1983, the Respondent, ("Hlavinka"), prepared and brought Pro Se a complaint against the Petitioners, Blunt, Ellis & Loewi Incorporated, John Fromm and Peter Pfeffer, ("Blunt"), before the Commodity Futures Trading Commission, ("CFTC"), under the reparation proceedings of Act, 7 U.S.C. Sec. 18 (1982). On October 22, 1986, an Administrative Law Judge, ("ALJ"), issued an initial decision, Petitioners Appendix 16-23 ("Pet. App."), in which he concluded that Hlavinka had not sustained his allegations that Blunt, a futures

commission merchant, and its agents, had violated the anti-fraud provisions of Section 4b of the Act, 7 U.S.C. Sec. 1 *et seq.* (1982), and dismissed the complaint. On November 10, 1986, Hlavinka again acting pro se appealed the initial decision to the CFTC. On September 18, 1987, the CFTC summarily affirmed without opinion. (Pet. App. 24-25).

Hlavinka appealed to the United States Court of Appeals for the Seventh Circuit, No. 87-2652, and then for the first time sought the advice of a lawyer.

The Seventh Circuit in *Hlavinka v. Commodity Futures Trading Com'n*, 867 F.2d 1029 (1989)("Hlavinka I"), held that there was no fraud, and that Hlavinka's negligence claim had no basis because for commodities fraud, negligence is not enough. *Hlavinka* at 1033. The court dismissed the complaint. (Pet. App. 26-32).

On February 22, 1989, with the statute of limitations running, Hlavinka brought an action in state court alleging Blunt had committed the state common law torts of breach of contract and negligence against him. (Pet. App. 13-15).

Blunt, after refusing to appear for Depositions, and facing a Motion to Compel Discovery, on April 17, 1989, petitioned the United States District Court for the Eastern District ("District Court"), for a permanent injunction and stay of the state court proceedings. A hearing was held before the Honorable Terence T. Evans on May 3, 1989. The petition was denied on May 18, 1989 by the District Court "reluctantly". (Pet. App. 6-10). The District Court stated that "the CFTC does not require that all claims and all theories of recovery that a customer has against a

broker – particularly those based on state law – be included in a reparations complaint. And it is doubtful whether all could be. . . . Mere negligence, or simple breach of contract claims, may not even be covered by the CEA", [Commodity Exchange Act ("CEA"), 7 U.S.C. Sec. 1 *et seq.*] (Pet. App. 9).

Blunt sought a reconsideration of the Order from the District Court. The District Court this time showing no reluctance denied the petition stating:

> "In my view, the petitioners misread the *Harper Plastics* case. In that case, the court of appeals considered whether *res judicata* bars a litigant from bringing a contract claim in state court following a dismissal on the merits of his federal antitrust claim in a federal district court. The difference between *Harper Plastics* and this case is both basic and simple. In *Harper Plastics* the plaintiff could have joined his state law claims in his federal court suit. Had he done so, his claims would have been resolved by an Article III judge. *In this case, the administrative judge had no jurisdiction to entertain state law claims.* They could not have been joined even though, under the peculiar circumstances of reparation proceedings, a counterclaim by a registered broker could have been entertained." (Order of U.S.D.C., E.D. Wisconsin, denying reconsideration, not reported, June 2, 1989),(Emphasis Added), (Pet. App. 11-12).

Blunt appealed from that order to the United States Court of Appeals for the Seventh Circuit.

In Blunt's brief to the Seventh Circuit and on oral argument, the issues of *res judicata*, collateral estoppel,

claims-splitting, claims-preclusion, issue-preclusion, election of remedies, and voluntary waiver were raised, fully briefed and argued.

The Seventh Circuit held that since the Commission had no jurisdiction over negligence or breach of contract tort claims such as contained in the Wisconsin suit, its dismissal of Hlavinka's administrative complaint is not *res judicata* as to breach of contract and negligence claims brought in state court.

Further, the Seventh Circuit stated while Hlavinka is entitled to pursue his breach of contract and negligence claims in state court, Hlavinka may not rely upon fraud in that forum because that matter was fully litigated before the Commission and before the Seventh Circuit. The Seventh Circuit stated an injunction restraining Hlavinka or his counsel from relitigating the question of fraud would effectuate the Seventh Circuit's judgment under the Anti-Injunction Act. (Pet. App. 4-5).

Blunt now seeks Certiorari claiming the Seventh Circuit in its decision, failed to address all of the issues raised by Blunt in its brief and on oral argument.

SUMMARY OF ARGUMENT

Res judicata applies only if an issue or claim was or could have been raised in a forum jurisdictionally able to hear it. An Administrative Law Judge in a reparations action cannot jurisdictionally decide whether negligence or breach of contract occurred, those decisions must be left to Article III courts with the jurisdiction to hear them.

The factors necessary to establish collateral estoppel are not present in the case before this Court, and the Court of Appeals for the Seventh Circuit acknowledged that lack by not giving credence to petitioners argument.

Public policy will be harmed if as Blunt argues, a person mistakenly bringing a claim in a court of limited jurisdiction, so that claim cannot be jurisdictionally heard, is forever barred from bringing that claim in a court with the proper jurisdiction to hear and decide it. The result will be an end to reparations, for fear of cutting off valid jurisdictional claims in another forum.

ARGUMENT

I. THE SEVENTH CIRCUIT WAS PROPER AND CORRECT IN ITS RULING

Blunt seeks Certiorari specifically because the Seventh Circuit did not address in its opinion all of the issues raised by Petitioner and fully discussed by both Petitioner and Respondent through Briefs and Oral Argument.

The Seventh Circuit was correct in its analysis that a non-Article III Court has no jurisdiction to hear a claim, which could not be raised or addressed by that forum, and if it could not be raised it is not barred by *res judicata*.

Section 14(a) of the Commodity Exchange Act ("CEA"), 7 U.S.C. Section 18(a), establishes the Commission's reparations procedures. The reparation procedure is designed as a quick and inexpensive forum where customers may seek damages for violations of the Act committed by industry professionals registered with the Commission.

Section 14(a) confines the Commission's reparation jurisdiction over customer claims to those based upon violations of the CEA or a rule, regulation or order issued under authority of the CEA. (App. 5-10).

By permission of the Commission the *Amicus Curiae* Brief of the Commodity Futures Trading Commission is attached as a reference in the Appendix because of the role it played in the Seventh Circuits opinion.

Blunt, in their brief again argues the same points, recklessly citing holdings and cases in support of their position as they did before the Seventh Circuit. Blunt argues that this court require the claimant to assert all claims he intends to present, based on a single cause of action [regardless of jurisdiction], in a single proceeding, whatever decisional forum he elects Petitioners Brief ("Pet. Br.") at 11.

Simply put, Blunt is either arguing that this court expand the jurisdiction of the CEA to cover any and all possible claims, or in the alternative, is asking that all claims beyond the jurisdiction of the reparations action simply be eliminated due to choice of forum. In support of these, Petitioners argue using the terms "claim-splitting" and cite to prohibitions because of *res judicata* and collateral estoppel.

A. THE CEA HAS NO JURISDICTION OVER COMMON LAW CLAIMS

The CEA has no jurisdiction over common law claims of negligence or breach of contract, unless they are brought as a counterclaim, permissible under *Commodity*

Futures Trading Commission v. Schor, 478 U.S. 833 (1985), or they rise to the level of a material misrepresentation of fact made by a commodity professional to be cognizable in reparations as violative of the Act's anti-fraud provisions (App. 7-8).

In *Schor* at 841-857, this court carefully analyzed the limited jurisdiction of the CEA compared to Article III Courts. *Schor* was limited, and very carefully limited to extending jurisdiction to common law counterclaims only, reserving common law claims, not brought as counterclaims to Article III Court.

Under Blunt's loose analysis of election of remedies, it cites to *Schor* stating the "opinion clearly states there is no constitutional impediment to the reparations proceeding deciding common law claims having nothing to do with the Commodity Exchange Act." (Pet. Br. at 14).

Schor's entire analysis is a limitation on extending jurisdiction to non-Article III Courts.

> "When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect. *Schor* at 851.
>
> "The CFTC's adjudicatory powers depart from the traditional agency model in just one respect: the CFTC has jurisdiction over common law counterclaims." *Schor* at 852.
>
> "Similarly, the state law character of a claim is significant for purposes of determining the effect that an initial adjudication of those claims by a non-Article III tribunal will have on the separation of powers for the simple reason that

> private, common law rights were historically the types of matters subject to resolution by Article III courts. See *Northern Pipeline*, 458 U.S. at 68, n 20, 84; id., at 90. (REHNQUIST, J., concurring in judgment). *Schor* at 854.
>
> "It also bears emphasis that the CFTC's assertion of counterclaim jurisdiction is limited to that which is necessary to make the reparations procedure workable. See 7 U.S.C. Sec. 12a(5)."
>
> *Schor* at 856.

Petitioners assertion that no constitutional impediment exists to permit reparations to decide common law claims is invalid.

The facts in *Schor* were that Schor and Mortgage Services of America invoked the reparations jurisdiction by filing complaints against Petitioner Conti, a commodities future broker and some employees. Before receiving notice that Schor had commenced the reparations action, Conti filed a diversity action in Federal District Court. Schor counterclaimed and then moved to dismiss the District Court action arguing the District Court action was a waste of judicial time and resources and all the rights of the parties would be resolved in the reparations action. Conti voluntarily dismissed the Federal District Court action and brought his debit balance claim as a counterclaim in a Commodities Futures Trading Commission ("CFTC") reparations proceedings.

The Administration Law Judge ("ALJ") ruled in Conti's favor and his counterclaims. Schor then for the first time challenged the CFTC's statutory authority to adjudicate Conti's counterclaim. The commission

declined to review and the Court of Appeals relying on *Northern Pipeline Construction Co. v. Marathon Pipeline Co.*, 458 U.S. 50 (1982), held that "Congress may not vest in a non-Article III court the power to adjudicate, render final judgment, and issue binding orders in a traditional contract action arising under state law, without the consent of the litigants, and subject only to ordinary appellate review." *Schor* at 838-839.

The Court of Appeals determined "Congress had no 'clearly expressed' or 'explicit' intention to give the CFTC constitutionally questionable jurisdiction over state common law counterclaims." *Schor* at 838-839.

The Court of Appeals reversed the ALJ and on Certiorari the court remanded the case for reconsideration. The Court of Appeals affirmed their decision, and this Court held that a specific exception to the limited jurisdiction of a CFTC ALJ in a reparations action exists, but only for state common law *counterclaims*.

The jurisdictional limits are clear, concise and specific, as shown by both *Schor* and argued by the Commission itself (App. 1-10). The CFTC has no jurisdiction to address common law negligence or breach of contract claims absent actual fraud, as held in *Hlavinka v. Commodity Futures Trading Com'n*, 867 F.2d 1029, 1033 (1989), ("Hlavinka I"), "As we have recently held, for commodities fraud, negligence is not enough."

Without jurisdiction to hear or address common law claims for negligence or breach of contract *res judicata* cannot apply.

Petitioner argues against both the Seventh Circuit and the Commissions position as opposite to *Schor* "(i.e., it is competent and empowered to decide state law issues presented by counterclaimants but not by claimants)." (Pet. Br. at 16). The analysis of *Schor* was that Congress had made clear their intent to extend the limited jurisdiction of the CFTC to include common law counterclaims and that the addition of counterclaims did not cross the constitutional boundaries between courts of limited jurisdiction and Article III Courts.

B. THE CASE LAW CITED BY BLUNT SHOWS COLLATERAL ESTOPPEL DOES NOT APPLY

Blunt properly addresses the requirements for collateral estoppel to apply (Pet. Br. 16-17), citing *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 327 (1979), and other cases as the basis for collateral estoppel. The proper requirements for collateral estoppel to be applied as argued by Blunt are as follows:

> "(1) the issue to be precluded must be the same as that involved in the prior action; (2) the issue must have been actually litigated; (3) the determination made of the issue must have been essential to the final judgment; and (4) the party against whom estoppel is invoked must have been fully represented in the prior action." *Klingman v. Levinson*, 831 F.2d 1292, 1295 (7th Cir. 1987); See *International Association of Machinists & Aerospace Workers v. Nix*, 512 F.2d 125, 132 (5th Cir. 1975) (and cases cited therein).

Blunt is correct, if all the factors listed above are present collateral estoppel applies. These same factors were argued before the Seventh Circuit, and for this

reason the Seventh Circuit did not address the collateral estoppel arguments of Petitioners. The factors are not present in this case.

(1) The issue to be precluded must be the same as that involved in the prior action. The ALJ found no fraud, the Seventh Circuit in *Hlavinka I* stated "for commodities fraud mere negligence is not enough." *Hlavinka* at 1033.

The Seventh Circuit in its most recent decision *Blunt, Ellis & Loewi, Inc. v. Hlavinka*, 897 F.2d 240 (1990), ("Hlavinka II"), determined the issue of *fraud* was decided and is now barred by *res judicata* [and collateral estoppel].

(2) The issue must have been actually litigated. The issues of negligence and breach of contract are beyond the jurisdiction of the CFTC in a reparations action and the ALJ. As such they cannot be raised let alone fully litigated. If they could not be raised due to jurisdictional limitations they could not be fully litigated.

(3) The determination made of the issue must have been essential to the final judgment. Simply put, was negligence or breach of contract essential or material to the ALJ's judgment? The Seventh Circuit in *Hlavinka I* stated:

> "Unfortunately, '[T]ests of materiality of misrepresentations, omissions, false reports, etc. have not yet evolved in commodities law. When they do, they should approximate the important-to-a-reasonable investor (or trader) test of 106-5 and the securities laws."

Hlavinka at 1034, note 14.

Nowhere in the ALJ's decision does he refer to "breach of contract" or "negligence". The ALJ had no cause or jurisdiction to examine those issues so they had no relation to the final determination he made that no fraud or violation of the CFTC rules or regulations existed.

(4) The party against whom estoppel is invoked must have been fully represented in the prior action.

Hlavinka was pro se before the ALJ, the Commission, and began his appeal before the Seventh Circuit pro se, seeking counsel only two weeks before the brief was due. He was not fully represented.

For the above reasons the Seventh Circuit did not fail to address Blunt's collateral estoppel arguments, but did not waste its time addressing meritless arguments.

Blunt strongly suggests that Pendant Jurisdiction allows the CFTC to address and try all state claims brought before it (Pet. Br. 15-16). Citing to *United Mine Workers of America v. Gibbs*, 383 U.S. 715, 725 (1966), one of the criteria given for Pendant Jurisdiction is "(1) a federal claim of sufficient substance to confer *subject matter jurisdiction* on the court." Simply put, since no jurisdiction is present pendant jurisdiction will not apply.

Blunt also argues collateral estoppel should bar an Article III court from hearing issues that could not be raised in a non-Article III Court of limited jurisdiction. "Collateral Estoppel treats as final only those questions actually and necessarily decided in a prior suit." *Montana v. United States*, 440 U.S. 147, 153 (1979); *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326 n. 5 (1979); *Brown v. Felsen*,

442 U.S. 127, 132 n. 10 (1979). Neither breach of contract nor negligence was actually or necessarily decided before the ALJ.

Blunt recklessly cites to *Terminal Warehouse Co. v. Pennsylvania R.R. Co.*, 297 U.S. 500 (1926), as standing for the proposition that a plaintiff who seeks monetary relief in a regulatory body has elected the agency remedy, and cannot thereafter seek relief before a court based on the same conduct. (Pet. Br. at 13.)

An examination of the *Terminal* decision shows that Blunt is mistaken his analysis and misapplies that decision in their brief.

Terminal held that where a litigant has two forums available, one of limited jurisdiction, and one Article III Court, each having identical remedies and both having the jurisdiction to address and decide all of the issues and claims brought before them by the litigant, the litigant cannot split his claims between those two forums, but must seek his relief in one or the other. In *Terminal*, each had jurisdiction to award the relief sought *and* the jurisdiction to decide all of the issues that were raised. *Terminal* does not, as Blunt argues, address what effect attempting to raise an issue or claim beyond the jurisdiction of the commission would have on a later suit before a court that jurisdictionally could hear it.

Terminal then is not the appropriate case to be examined, rather *Northern Pipeline* and *Schor* provide the analysis and considerations necessary to decide the jurisdictional questions between non-Article and Article III courts.

The key point returns to whether the court or forum can jurisdictionally hear the issue raised before it.

The cases cited by Blunt, (Pet. Br. 18-19), in support of their position concerns Article III Courts which have the jurisdiction to hear and decide the issues brought before them. Absent jurisdiction, an issue cannot be raised, let alone be fully litigated.

Finally, Blunt cites to *Washington v. Sec. of Health, Education and Human Services*, 693 F.Supp. 569, 573 (N.D. Ohio, 1988), that the *res judicata* effect of an agency decision adjudicatory in nature was "essentially black letter law." (Pet. Br. 23). That is a patent misapplication of that decision. The "Black Letter Law" referred to in *Washington* is that an order by an administrative agency that is not appealed is final.

The decision goes on to say: "Indeed, an administrative order cannot be collaterally attacked, unless the agency acted in excess of its jurisdiction . . . " (Citations omitted), *Washington* at 573.

II. PUBLIC POLICY ARGUMENTS

The basic argument Petitioners raise is simply this: it is too much of a burden for commodities brokers to prove no fraud or violation of the Commission rules and then have to defend against claims that jurisdictionally could not be raised at reparations, but are brought in a later suit before a forum with jurisdiction.

If what Petitioner suggests occurs, reparations will be dead as an avenue of relief.

If a customer following the quick, easy and inexpensive forum of reparations, often acting pro bono as in this case, is then barred from pursuing claims outside of the jurisdiction of the CEA reparations action in state or Federal court. The result will be to eliminate reparations as an alternative, thus crowding the courts and eliminating the purpose of quick, inexpensive access for a disgruntled customer. Under the ruling Blunt urges, any lawyer bringing a reparations action, when he or she believes that a common law claim may be present, could be charged with malpractice. Likewise, a customer, encouraged by the Commissioner to pursue reparations would never get an opportunity to fully litigate claims against a broker, if actual fraud or a violation of the CEA were not found.

In either event, reparations would die a quick and needless death. The congressional purpose would be aborted and a method that currently clearly works to ease crowded calendars would be eliminated.

Petitioners argue against the cost and burden of winning at reparations and then facing the costs and expense of a suit on claims which jurisdictionally could not be heard in reparations.

Where is the burden? Brokers are becoming rich off of commodity customers, the brokers are not nor should they be a protected class, rather every incentive should be present to make them more careful with the client's funds.

Under the scheme Blunt urges, only those too unsophisticated to understand the limits would seek reparations, all others would opt for the cost and burden of

Article III Courts, destroying the congressional intent of Congress and clogging the courtrooms.

CONCLUSION

The intent of Congress is clear, as is the analysis of *Schor*, and the Seventh Circuit. The issue of fraud was decided as *res judicata*.

Res judicata and collateral estoppel start at whether the court or forum had jurisdiction and based on that jurisdiction, if all the issues were or could have been raised.

Blunt mistakenly asks this court to apply *res judicata* and collateral estoppel to limit the trial of a claim or dispositive issue to one fully-reviewed proceeding. (Pet. Br. at 26). *Res judicata* and collateral estoppel relate to those issues that were or could have been raised jurisdictionally in the court or forum, and not as Blunt suggests whether the proceeding was fully reviewed.

Neither should the jurisdiction of the CFTC be increased, nor should a new theory of law ignoring jurisdiction be adapted, both are arguments Blunt seems to be making in their brief. The CFTC in its Amicus Curiae Brief did not share Blunts arguments in increasing jurisdiction.

The District Court properly held that the administrative law judge had no jurisdiction to entertain state law claims.

Likewise, the Seventh Circuit properly found the Commission had no jurisdiction over negligence and

breach of contract claims, but that fraud, fully litigated before the Commission is barred by *res judicata*, and the order for the injunction barring relitigation on fraud is proper.

Respondents respectfully request this Court to deny the Writ for Certiorari as the law on *res judicata* and collateral estoppel were considered, addressed and properly decided by the Seventh Circuit.

Respectfully Submitted,

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DATE: June 14, 1990

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

No. 89-2265

BLUNT, ELLIS & LOEWI, INC., JOHN FROMM
and PETER PFEFFER,

Petitioners – Appellants,

v.

RONALD P. HLAVINKA and JIMMIE G. DAVISON,

Respondents – Appellees

On Appeal from the United States District Court
for the Eastern District of Wisconsin

BRIEF AMICUS CURIAE OF THE COMMODITY FUTURES TRADING COMMISSION

INTEREST OF THE COMMODITY FUTURES TRADING COMMISSION

The Commodity Futures Trading Commission ("Commission" or "CFTC") is the independent federal regulatory agency which administers and enforces the Commodity Exchange Act ("CEA" or "Act"), 7 U.S.C. §§ 1 *et seq.* Implicit in this mandate is the responsibility to ensure that the provisions of the CEA are interpreted in a manner consistent with Congressional purposes.

Section 14(a) of the CEA, 7 U.S.C. § 18(a), establishes the Commission's reparation procedures. The reparation

program is designed as an inexpensive forum where customers may seek damages for violations of the Act committed by industry professionals registered with the Commission. In the case at bar, petitioners-appellants Blunt, Ellis & Loewi, Inc. ("Blunt Ellis"), John Fromm and Peter Pfeffer assert, among other things, that the Commission is empowered to entertain state law claims in the reparation forum, and that this jurisdiction undercuts the district court's determination to allow an unsuccessful complainant before the Commission to press common law claims in state court growing out of the same operative facts. In view of the importance of this question under the CEA, the Commission believes it is appropriate to present its views before this Court.

STATEMENT OF THE CASE

On February 6, 1989, this Court denied Ronald P. Hlavinka's petition for review of a Commission order issued in a reparation proceeding under Section 14 of the CEA. *Hlavinka v. CFTC*, 867 F.2d 1029 (7th Cir. 1989). The Commission had dismissed Hlavinka's complaint for monetary damages against Blunt Ellis for failure to sustain his allegations that Blunt Ellis, Fromm and Pfeffer had violated the anti-fraud provisions of the Act.[1], *Hlavinka v. Blunt, Ellis, Loewi*, [1986-1987 Transfer Binder]

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[1] Specifically, Hlavinka had contended that the futures commission merchant (Blunt Ellis) and its associated persons (Fromm and Pfeffer) knew or should have known about COMEX rules affecting price limits and that their failure to impart correct information caused him substantial losses.

Comm. Fut. L. Rep. (CCH) ¶ 23,324 (ALJ 1986); *Hlavinka v. Blunt, Ellis & Loewi, Inc.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,906 (CFTC 1987).

Sixteen days after entry of this Court's decision, Hlavinka filed a complaint against petitioners in the Circuit Court of Milwaukee County, Wisconsin, apparently based upon the same operative facts as his earlier reparation complaint. *Hlavinka v. Blunt Ellis & Loewi, Inc., John Fromm and Peter Pfeffer*, Case No. 89 CV 02529 (Circuit Court of Milwaukee Cty., Wis.)(the "state court action"). See Petitioners' Appendix ("Pet. App.") at 27-29. Hlavinka's state court action alleges two theories of recovery, breach of contract and negligence, and seeks compensatory and punitive damages.

Blunt Ellis then commenced a permanent injunctive action in U.S. District Court for the Eastern District of Wisconsin against Hlavinka and his attorney, Jimmie G. Davison. Pet. App. at 20-26. Specifically, Blunt Ellis seeks to stay the state court action and to restrain Hlavinka and Davison "from taking any further action in the Circuit Court of Milwaukee County or in any state or federal tribunal in connection with a matter litigated on the merits in the reparation proceeding or which could have been litigated in such proceeding." Pet. App. at 25.

On May 18, 1989, the district court denied Blunt Ellis' request for injunctive relief. *Blunt Ellis & Loewi, Inc. v. Hlavinka*, 711 F. Supp. 950 (E.D. Wis. 1989). As framed by the district court, the issue presented was "whether a customer – like Hlavinka here – can choose a forum – like the CFTC's reparations procedures – lose there, and then press a state law cause of action in state court growing

essentially out of the same set of facts." 711 F. Supp. at 952.

In ruling against Blunt Ellis, the district court found in pertinent part that "the CFTC does not require that *all* claims and *all* theories of recovery that a customer has against a broker – particularly those based on state law – be included in a reparations complaint" and that "[m]ere negligence, or simple breach of contract claims, may not even be covered by the CEA." *Id.* (emphasis in original). Based upon those findings, the district court concluded that the CEA does not "preempt all state law claims and transfer them to non-Article III administrative judges in CFTC hearings. . . . " *Id.* Moreover, on June 2, 1989, the district court denied petitioners' motion for reconsideration, holding that "the administrative judge had no jurisdiction to entertain state law claims." Pet. App. at 18-19. This appeal ensued.

ARGUMENT

I. Introduction

On appeal to this Court petitioners argue, among other things, that the district court erred because the statutory scheme establishing the reparation procedures does not permit a claimant to split his state and federal law claims. Petitioners Brief ("Pet. Br.") at 21-28. Petitioners presume for this purpose that Section 14 of the CEA empowers the Commission to hear pendent state law claims in the reparation forum. Pet. Br. at 22. As a corollary, petitioners assert that the Commission

currently considers state common law issues in the reparation forum, particularly customer claims alleging the breach of a broker's fiduciary duties. Pet. Br. at 25.

As explained below, Section 14(a) confines the Commission's reparation jurisdiction over customer claims to those based upon violations of the CEA or a rule, regulation or order issued under authority of the CEA. Consequently, the Commission has refused to hear customer breach of contract claims as well as claims based upon a violation of a rule of a contract market. For this reason, the district court was correct to conclude that Hlavinka would have been unable to pursue state law claims in the reparation forum.

II. The District Court Properly Concluded That Hlavinka Could Not Have Raised His State Law Claims In The Reparation Forum.

Section 14(a) of the CEA provides that:

> Any person complaining of any violation of any provision of this Act or any rule, regulation, or order issued pursuant to this Act by any person who is registered under this Act may, at any time within two years after the cause of action accrues, apply to the Commission for an order awarding damages proximately caused by such violation.

Moreover, although Section 14(b) empowers the Commission to "promulgate such rules, regulations, and orders as it deems necessary or appropriate for the efficient and expeditious administration of this section," it does not confer jurisdiction to entertain a customer's state common law claims against an industry professional. The

Commission's rules explicitly authorize reparation complaints only as to allegations of violations of the CEA or rules, regulations or orders issued pursuant to the Act.[2]

Commission case law additionally makes clear that the reparation forum is to be confined to violations of the CEA or Commission rules or orders. In *Wills v. First Financial Corp. of America*, [1984-1986 Transfer Binder] Comm. Fut. L. Rep. (CCH) § 22,605 (CFTC 1985), a commodity customer sought to press a breach of contract claim in the reparation forum. In rejecting that effort, the Commission emphasized that "the critical element for reparations purposes is a provision of the Act or a Commission requirement which prohibits the conduct constituting the breach." *Id.* at 30,596. Ultimately, the Commission reasoned that, absent proof the conduct constituting the breach of contract *also* violated the CEA or a Commission rule, regulation, or order, the "mere breach of contract by [a futures commission merchant] is not cognizable in reparations under Section 14(a) of the Act." *Id.* at 30,596-97.

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[2] Specifically, Commission Rule 12.13(a), 17 C.F.R. § 12.13(a) tracks the statute:

> Any person complaining of a violation of any provision of the Act or a rule, regulation or order of the Commission thereunder by any person who is a registrant . . . may . . . apply to the Commission for a reparation award by filing a written complaint which satisfies the requirements of this rule.

Similarly, Commission Rule 12.13(b), which prescribes the form of reparation complaints, exhorts complainants to identify the "provisions of the Act, rule, regulation, or order claimed to have been violated." 17 C.F.R. § 12.13(b)(iii).

In *Wills*, the Commission also distinguished between breach of contract and fraud proscribed by the CEA. Failure to perform a contract is not itself an independent violation of the CEA. *Wills* at 30,596-97. However, a material misrepresentation of fact made by a commodity professional is cognizable in reparations as violative of the Act's anti-fraud provisions. *See* Sections 4b and 4o, 7 U.S.C. §§ 6b and 6o.[3] As a result, in particular

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[3] Section 4b provides, in pertinent part:

> It shall be unlawful . . . for any person, in or in connection with any order to make, or the making of, any contract of sale of any commodity for future delivery, made, or to be made, for or on behalf of any other person if such contract for future delivery is or may be used for (a) hedging any transaction in interstate commerce in such commodity or the products or byproducts thereof, or (b) determining the price basis of any transaction in interstate commerce in such commodity, or (c) delivering any such commodity sold, shipped, or received in interstate commerce for the fulfillment thereof –
>
> > (A) to cheat or defraud or attempt to cheat or defraud such other person . . .

Section 4o provides, in pertinent part:

> (1) It shall be unlawful for a commodity trading advisor, associated person of a commodity trading advisor, commodity pool operator, or associated person of a commodity pool operator by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly –
>
> > (A) to employ any device, scheme, or artifice to defraud any client or participant or prospective client or participant; or

(Continued on following page)

circumstances, conduct amounting to a breach of contract may also be actionable as fraud.[4]

The Commission has also recognized that it lacks jurisdiction to entertain reparation claims based exclusively upon violations of contract market rules.[5] In *Graves v. Shearson Hayden Stone. Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,301 (CFTC 1981), complainants sought reparations based upon a broker's violation of a contract market rule which prohibited the trading of accounts below a minimum equity amount. The Commission explained that Section 14(a) grants it

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(B) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or participant or prospective client or participant.

[4] For example, this might occur if a commodity professional entered into a contract without any intent to perform. In that situation, the formation of the contract could be a fraud on the customer and thus actionable in reparations. *Wills* at 30,597. See also *Trust & Investment AG v. Stotler & Co.*, [Current Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,928 at 34,265 (CFTC 1987), *aff'd sub nom. Trust & Investment AG v. CFTC*, No. 87-4099, (2d Cir. 1988) (unpublished) (where complainant's claim is based upon a contract dispute, "absent allegations of fraud in the making of the contract, it does not state a claim in reparations.")

[5] A board of trade or commodity exchange designated by the Commission for the purchase and sale of contracts for future delivery is a contract market under the CEA. See Section 4(a) of the Act, 7 U.S.C. § 6(a). Examples include the Board of Trade of the City of Chicago and the Chicago Mercantile Exchange, Inc.

jurisdiction to adjudicate claims against commodity professionals based only upon violation of any provision of the CEA or any rule, regulation, or order thereunder. Accordingly, it held that "conduct by a registrant in violation of a contract market rule which does not independently violate any provision of the Act, or a Commission rule, regulation or order thereunder is not actionable under Section 14 of the Act." *Id.* at 25,521.[6]

Notwithstanding these explicit holdings, petitioners suggest that the Commission already awards reparations based upon breaches of fiduciary duty which have their source in state law. Pet. Br. at 25. That argument is without substance, however, as it fails to recognize that the duties of commodity professionals which are the subject of adjudication in the reparation forum are the creation of federal law, namely, the CEA. As the Commission pointed out in analogous circumstances in *Graves, supra,* at 25,522:

> [W]hen a duty arises *only* as the result of . . . a supplementary contract market rule, as opposed to a Commission or congressional policy determination, conduct violative of such a duty falls outside of the Commission's reparations jurisdiction.

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[6] On the other hand, Commission Rule 12.19, 17 C.F.R. § 12.19, explicitly permits a registrant to file any counterclaim "which at the time the complaint is served the registrant has against the complainant if it arises out of the transaction or occurrence or series of transactions or occurrences set forth in the complaint." The jurisdictional basis of this rule lies in Section 14 and the Act's legislative history. *See CFTC v. Schor,* 478 U.S. 833, 841-847 (1986). Counterclaims are not at issue in the case at bar.

CONCLUSION

The district court properly recognized that the reparation forum is not available to complainants seeking damages based upon violations of state law.

Respectfully submitted,

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Dated: October 11, 1989